MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 3, 2016/2017

BAC3664 – ACCOUNTING THEORY

(All Section / Groups)

31 MAY 2017
9.00am -12.00p.m
(3 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consists of 2 pages with 4 questions only.

2. Attempt **ALL** questions. All questions carry equal marks and distribution of the marks for each question is given.

3. Please write all your answers in the Answer Booklet provided.

QUESTION 1

a) Accounting has been considered to serve many roles. Discuss the following;
   i. Accounting as economic goods (4 marks)
   ii. Standard setting as political process (4 marks)

b) There are two traditional approaches of theory construction that provide an insight on how theories are constructed. These are the inductive approach and deductive approach. Differentiate between the inductive and deductive approaches in the construction of accounting theory. (8 marks)

c) Discuss the development of positive accounting theory. How was positive accounting theory approach formulated and differs from normative and pragmatic approach? (9 marks)

Total: 25 marks

QUESTION 2

a) Explain **FOUR (4)** purposes for establishing the conceptual framework. (8 marks)

b) Standard overload is defined when 'the amount of information required to be supplied by reporting entity exceeds the amount reasonably required by users in making economic decision". Discuss how standard overload may adversely affect the usefulness of financial reporting. (8 marks)

c) It is argued that the development of a conceptual framework may be inappropriate because accountants constantly deal with specific issues such as issues in assets recognition for agriculture. Do you agree or disagree? Please state your argument. (9 marks)

Total: 25 marks

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QUESTION 3

A key to explaining managers' choice of particular accounting methods came from Agency Theory. Agency Theory provided the necessary explanation of why the selection of accounting method might matter, and hence was an important facet in the development of Positive Accounting Theory.

a) In the agency theory literature, the firm itself is considered to be a nexus of contracts. Briefly explain what it means to say that an organisation can be represented as a " legal nexus of contract" (5 marks)

b) What is agency relationship and what is an agency cost? How can agency cost be minimized? Explain. (10 marks)

c) According to *'bonus plan hypothesis'*, it is argued that rewarding mangers on the basis of accounting profits may induce them to manipulate accounting income. Discuss how managers may manipulate accounting numbers opportunistically due to the presence of accounting-based bonus schemes.

(10 marks)

Total: 25 marks

QUESTION 4

a) If markets are informationally efficient, corporate news events such as earnings announcements should be immediately reflected in stock prices. However, connecting stock-price reactions to corporate events is not as straightforward as it sounds. Discuss other factors which can affect the association between profits and share prices. (5 marks)

b) Evaluate the following statement: If an item of accounting information is released by corporation and there is no apparent change in the share price of the company, the information is not relevant to the market and therefore there is no point in disclosing such information again. (10 marks)

c) Various stakeholders have different views of what the trade-offs between relevance and reliability should be. This is because different stakeholders attach different importance to one quality as opposed to another. Provide **TWO (2)** examples of such trade-offs. Explain the opposing views which would favor one over the other.

(10 marks)

Total: 25 marks

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